

State Notes

TOPICS OF LEGISLATIVE INTEREST

January/February 2004



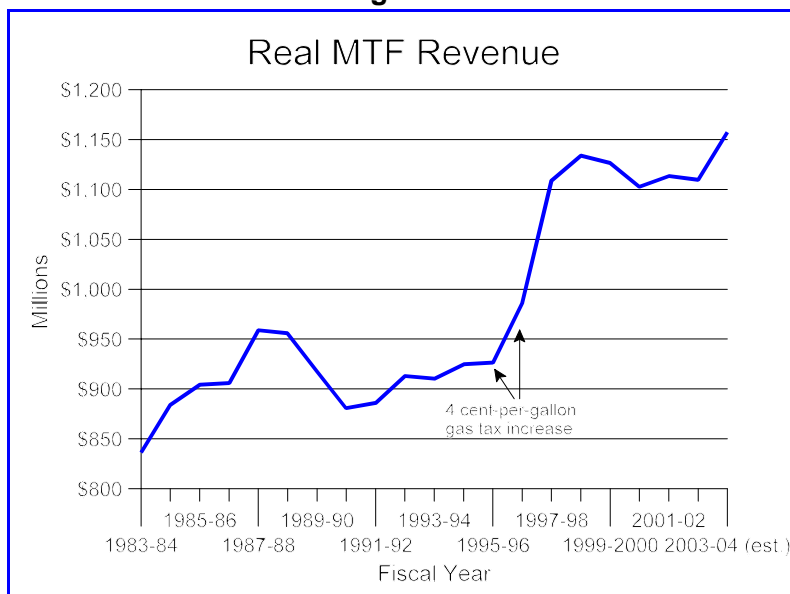
Growth in the Michigan Transportation Fund and its Components by Craig Thiel, Fiscal Analyst

Introduction

The Michigan Transportation Fund (MTF) is the recipient of all constitutionally restricted motor fuel taxes and vehicle registration taxes and therefore is the primary State-generated funding source for transportation activities in Michigan. The MTF is expected to receive over \$2.1 billion in fiscal year (FY) 2003-04 from motor fuel taxes (52.4%), vehicle registration taxes (44.6%), and a combination of vehicle title and transfer fees, various permit fees, and interest earnings (3.0%). Because the MTF supports funding for various transportation-related investments in Michigan, including the State's road and bridge program, local roads and bridges, and all modes of public transportation, growth in the MTF is an important issue.

While the MTF experienced inflation-adjusted revenue growth of 38.4% over the period FY 1983-84 through FY 2003-04, real MTF revenue has decreased in three of the last five years (Figure 1). Constrained growth in the MTF is further magnified in light of annual increases in vehicle miles traveled, increasing road and bridge construction costs, and rising operating costs for public transit agencies. This article provides an overview of the major components of the MTF and compares their growth over the past 20 years (FY 1983-84 through FY 2003-04) with overall revenue growth in the MTF.¹

Figure 1



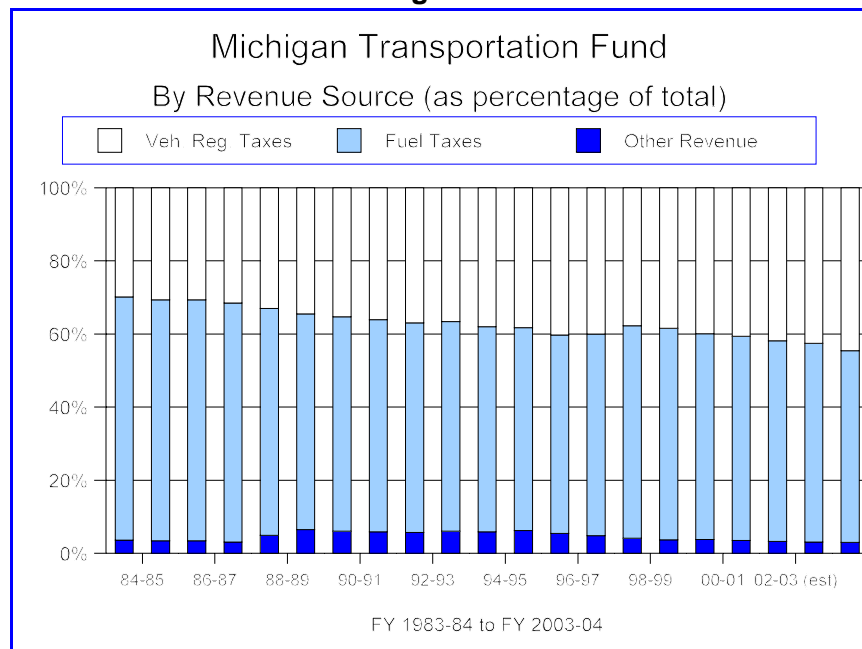
¹ Fiscal year 1983-84 was chosen as the base comparison year because that was the last year in which all motor fuel taxes, as a group, were increased (from 13 cents per gallon to 15 cents per gallon) and Michigan changed from a weight-based to a value-based vehicle registration tax. (Note: The gasoline tax was increased in 1997 to 19 cents per gallon.)



Motor Fuel Taxes

Michigan's Motor Fuel Tax Act provides for a 19-cent-per-gallon tax on gasoline and a 15-cent-per-gallon tax on diesel fuel and liquified petroleum. In FY 2003-04 motor fuel taxes are estimated at \$1.1 billion. The percentage share of total MTF revenue from State motor fuel taxes decreased from 66.5% in FY 1983-84 to 52.4% in FY 2003-04. Figure 2 shows MTF revenue by source, as a percentage of total revenue. Gasoline tax revenue comprises 86.1% of total motor fuel tax revenue deposited in the MTF.

Figure 2



Michigan's 19-cent-per-gallon gasoline tax is slightly below the national average of 20.4 cents per gallon; however, Michigan also assesses its 6% sales tax on gasoline. As a result, Michigan's effective tax on gasoline, including the sales tax, is 26.9 cents per gallon, above the national average of 21.4 cents per gallon. Among the Great Lakes states, the average gasoline tax is 21.7 cents per gallon without sales tax. When the sales tax is factored in for those states levying such a tax on gasoline (Illinois, Indiana, and Michigan), the average is 26 cents per gallon. Overall, Michigan's gasoline tax burden is on par with national and regional averages.

During the period FY 1983-84 to FY 2001-02, nominal gasoline tax revenue grew from \$527.7 million to \$963.5 million, an increase of 82.6%. Even after the 4-cent-per-gallon gasoline tax increase in 1997, real gas tax revenue (adjusted for inflation) grew only 1.4% over this same time period. Gasoline tax revenues have trailed behind inflation primarily due to advances in fuel efficiency coupled with the fact that Michigan's motor fuel taxes are fixed amounts per gallon. In addition to these factors, the growth of alternative fuel vehicles has contributed, albeit to a very small degree, to the slow growth in fuel tax collections.



Because Michigan's fuel taxes are fixed amounts per gallon, the growth in motor fuel tax receipts has been constrained by gains in fuel efficiency. Although vehicle miles traveled in Michigan increased 49.4% from 65.7 billion miles in 1984 to 98.2 billion miles in 2002, increased fuel efficiency of vehicles traveling in Michigan during the same period inhibited the increase in the number of gallons of motor fuel consumed. From FY 1983-84 to FY 2001-02, gasoline consumption in Michigan increased 32.7%, from 3.8 billion gallons taxed to 5.0 billion gallons taxed (Figure 3). Because fuel efficiency growth has outpaced the increase in vehicle miles traveled, gas consumption per vehicle has decreased. This has suppressed the growth of motor fuel tax revenue deposited in the MTF.

Figure 3

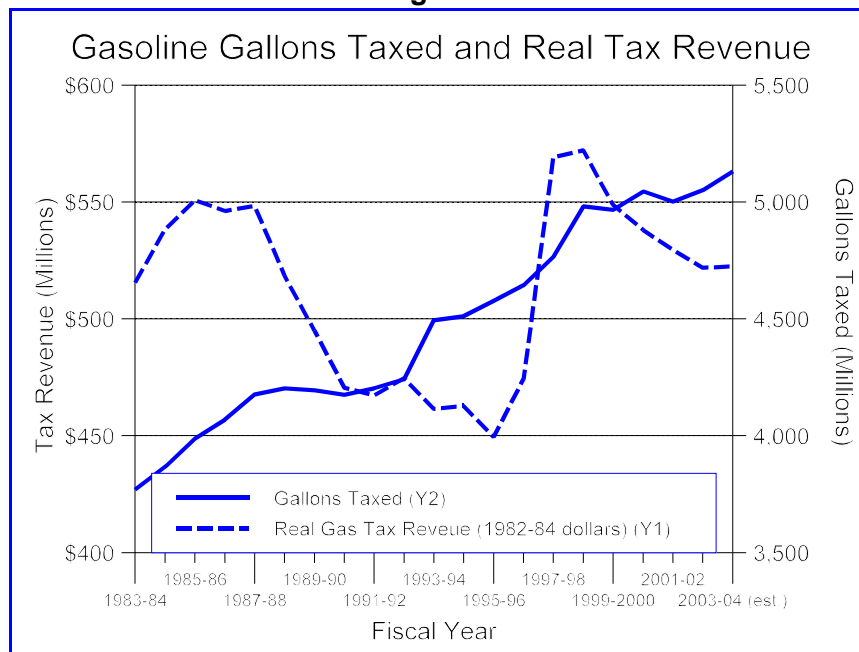


Figure 3 displays inflation-adjusted gas tax revenue growth. Between the time of the 1984 gas tax increase and the 1997 gas tax increase, real gas tax revenue declined 18% from its peak in FY 1986-87. Since the 1997 gas tax increase, inflation-adjusted revenue has dropped 8.7% from its peak in FY 1998-99. In terms of real dollars, gas tax revenue in FY 2003-04 is expected to be \$72.9 million above the level in FY 1995-96, the year immediately preceding the 1997 tax hike. In other words, inflation has not completely eroded the increase in gas tax receipts realized from the 1997 tax bump.

Vehicle Registration Taxes

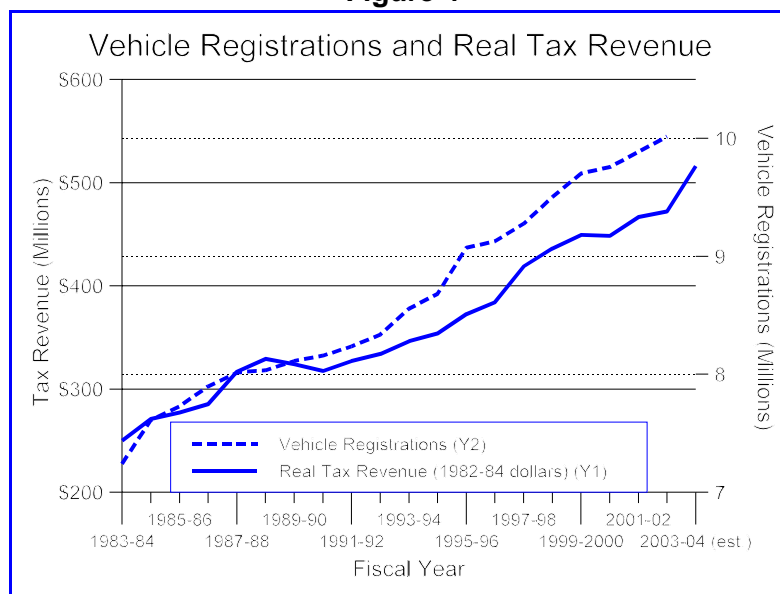
The State annually collects a tax on all vehicles registered in Michigan for use on public roads and highways. In FY 2003-04 this tax revenue is estimated to generate \$951.2 million, comprising 44.6% of the total MTF revenue, an increase from the FY 1983-84 level when registration taxes



made up 29.9% of total MTF revenue (Figure 2). Beginning with the 1984 model year, vehicle registration taxes changed from a weight-based to a value-based tax.

Over the 20-year period from FY 1983-84 to FY 2003-04, total vehicle registrations increased 36.5%. During the same period, however, inflation-adjusted vehicle registration tax revenue has increased 106.4%, from \$249.9 million to \$515.9 million (Figure 4). Initially, the majority of the growth in vehicle registration tax revenue was the result of changing from levying the tax on a vehicle's weight to levying the tax on a vehicle's value. As more and more vehicles became subject to the value-based tax and fewer vehicles subject to the weight-based tax, annual growth in tax receipts resulted from the rising costs of motor vehicles. Unlike motor fuel taxes, the vehicle registration tax has a built-in inflation factor in that it is an ad valorem tax, i.e., based on the value of the vehicle. In addition to the tax structure, the increase in the number of registrations over the past 20 years partially explains the growth in tax revenue. By indexing vehicle registration taxes to the value of motor vehicles, the tax revenue generated is not eroded by inflation. However, the annual growth in vehicle registration tax revenue is not enough to make up for the lost buying power associated with the stagnant fuel tax revenue collections.

Figure 4

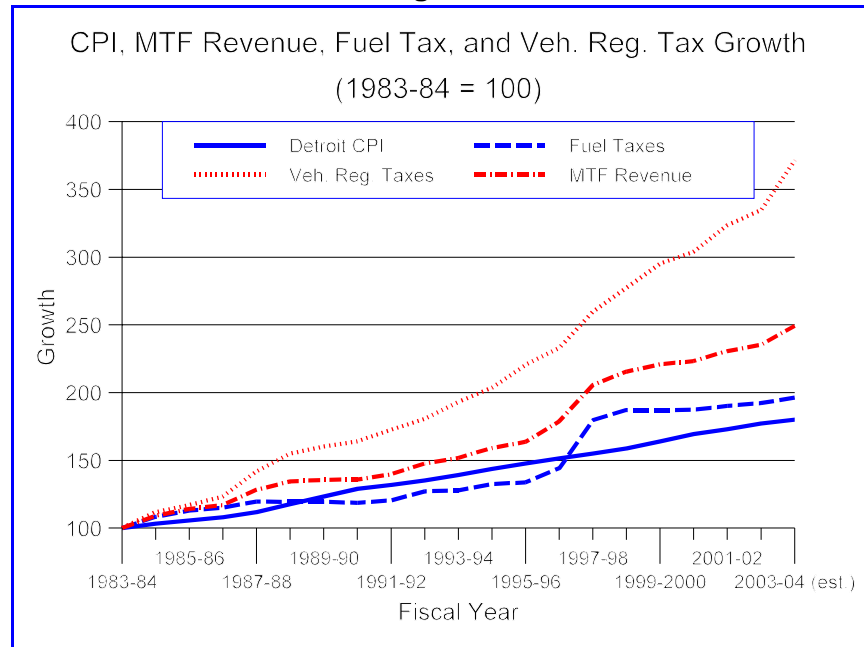


Conclusion

Figure 5 compares the growth in motor fuel tax revenue, vehicle registration tax revenue, MTF revenue, and the Detroit consumer price index over the past 20 years. This graph shows that growth in the MTF has been effectively driven by growth in vehicle registration taxes and not motor fuel taxes. While vehicle registration revenue growth has experienced steady year-to-year increases, fuel tax revenue growth has been relatively flat, with the exception of the 1997 gas tax increase. Because motor fuel tax revenue accounts for over half of the revenue deposited in the MTF, the slow growth in gallons taxed combined with the fact that the tax is a fixed amount per gallon has constrained MTF growth. As a result, the MTF is becoming increasingly more reliant on vehicle registration taxes than on motor fuel taxes as a revenue source.



Figure 5



Between FY 1983-84 and passage of the 1997 gasoline tax increase, growth in motor fuel tax revenue generally followed the growth in inflation. Since passage of the 4-cent-per-gallon tax increase, inflation has been rising faster than growth in fuel tax revenue receipts and is slowly eroding the initial bump in buying power realized immediately following the tax increase (Figure 5). Over the period FY 1998-99 to FY 2003-04, the average annual growth rate in fuel tax receipts is 1.5% compared with 2.5% for inflation. While a gasoline tax increase can produce short term revenue gains relative to inflation, it does little to provide long-term, ongoing growth in revenue receipts. Over time, inflation will erode the buying power of the additional tax revenues.

Sources: U.S. Department of Transportation, Federal Highway Administration, Census Bureau, and the Michigan Department of Transportation.

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Drug Importation from Canada: The Right Prescription for States? **By Dana Patterson, Fiscal Analyst**

Introduction

Currently, the Federal government, citing safety concerns, bars U.S. pharmacies and individual consumers from importing foreign drugs, including drugs from Canada. Nevertheless, this has not stopped thousands of individuals, the majority of whom are elderly and/or do not have third-party coverage for prescription drugs, from crossing the border into Canada to purchase pharmaceuticals, or from simply ordering their prescription drugs over the Internet from Canadian pharmacies. In recent months, interest in this idea has spread to the states. So far, at least 12 states have expressed their desire to import lower-cost prescription drugs from Canada on a large-scale basis for state employees, retirees, and/or prisoners, in attempts to save money and, apparently, to draw the attention of the Federal government and pharmaceutical manufacturers to the plight of states' rising pharmaceutical expenditures.

This article will provide a brief overview of the potential benefits of a drug importation program for individuals who do not currently have prescription drug coverage, people who have insurance coverage through state-sponsored health plans (i.e., state employees and retirees), and the states that pay for this coverage. The intent of this article is not to provide a dollar estimate of potential cost savings that could occur if an importation program were implemented, but rather to highlight some potential benefits, as well as some potential pitfalls, of this policy option.

Importing Prescription Drugs: the Uninsured, the Insured, and the States

In the U.S. pharmaceutical market, different payers pay different prices. Cash-paying customers, or people without prescription drug coverage, are required to pay the full retail price for prescription drugs. Third-party payers, however, such as pharmacy benefit managers or health maintenance organizations (often used by states to provide coverage for their employees and retirees), are able to negotiate discounts and manufacturer rebates for prescription drugs purchased for their members. Government programs, such as the U.S. Department of Veterans Affairs or state Medicaid programs, can achieve even greater reductions.

The Uninsured

The group that would most clearly benefit from importing lower-cost drugs from Canada would be those individuals who do not currently have prescription drug coverage and so must pay the cost of their prescriptions out-of-pocket at the full retail price. All savings achieved from purchasing cheaper drugs in Canada would directly benefit the individual consumer; access to prescription drugs could be increased for those who have been previously unable to pay for their prescription drugs under current U.S. pricing.

The Insured

State employees and retirees also could benefit from a state program to import prescription drugs from Canada. While their access to prescription drugs would not be affected (since they



already have access), these individuals could benefit from costs savings if, as an incentive for participation in a drug importation program, their insurer waived or reduced copayments for prescription drugs.

The States

Supporters of drug importation programs have made claims that such programs could benefit states by saving them millions of dollars on prescription drug expenditures for state employees and retirees. Many of the cost savings estimates provided thus far, however, appear to be optimistic because they fail to account for other variables that offset some of the potential savings. Therefore, the potential benefit to states is less than clear.

Probably the most widely publicized cost savings estimate comes from the State of Illinois. A report to the Governor of Illinois from the Office of the Special Advocate for Prescription Drugs found that the state could save as much as \$90.7 million per year (\$56.5 million to the state; \$34.2 million to state employees and retirees) by implementing a drug importation program. Soon after the release of the report, however, the U.S. Food and Drug Administration (FDA) issued a statement harshly criticizing the estimate. The FDA stated that the estimate appears to represent an implausible upper-boundary in part because the estimate assumes that 100% of eligible prescriptions would be filled through the proposed Canadian mail-order plan. The Illinois report itself states that the current domestic mail-order participation rate in Illinois is only approximately 7% of eligible prescriptions. In addition, the FDA stated that the estimate omits costs associated with shipping, pharmacists, and liability that would need to be included in order to provide a realistic estimate.

It should be noted that while most studies agree that brand-name prescription drugs are more expensive in the U.S. than in Canada¹, studies have not agreed on the size of this difference. Limitations in the current research result from comparing drugs at different points in the drug distribution chain (i.e., manufacturer, wholesale, or retail), comparing prices achieved by different payers, and comparing samples of different drugs. Having an accurate idea of the size of the discount that could be achieved through an importation program is important because states are already able to obtain significant discounts and rebates for their employees and retirees through the bulk-purchasing of prescription drugs. It is plausible that the amount of savings possible through an importation program would not be substantially greater than the current discounts.

Another concern regarding the validity of the savings estimates provided thus far, including the estimate from Illinois, is that they have assumed drug manufacturers would not alter their behavior in response to large-scale programs to import drugs to the U.S. from Canada. This is despite the fact that several drug manufacturers have threatened and even begun to take actions to limit the supply of drugs exported to Canadian wholesalers and retailers who are making their drugs available to the U.S. market. It was recently reported in the press that Pfizer is stepping up its efforts to stop pharmaceutical imports from Canada by imposing new

¹While brand-name drugs are more expensive in the U.S., generic drugs tend to be less expensive in the U.S. than in Canada. Just under half (approximately 46%) of the prescription drugs used in the U.S. are generic.

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restrictions on sales to Canadian wholesalers. Under a new sales policy, drug distributors will be authorized to deal only with approved purchasers of Pfizer products. The Pharmaceutical Research and Manufacturers of America (PhRMA) also has stressed its opposition to importation programs by stating that lobbying against the legalization of such programs will be a top priority for its organization this year. The success of pharmaceutical companies at limiting drug sales to Canadian pharmacies that export drugs to the U.S. would severely reduce the ability of states to run successful importation programs and achieve the estimated savings.

Finally, because implementing a drug importation program would be in direct conflict with Federal law, any state that does so could face civil lawsuits. The FDA has stated that litigation against states is an option if the agency considers it necessary to protect the public health. In addition, the FDA warns that states could face criminal action and financial liability if anyone is harmed by imported drugs.

Conclusion

States, as well as individual citizens, are facing continuing pressure from rising pharmaceutical expenditures. Importing drugs from Canada is being touted as a way to improve access to prescription drugs for those that cannot afford them and to provide some fiscal relief for states and their residents. Before pursuing drug importation programs, states must carefully consider whether the potential benefits of this proposal are real, and whether they outweigh the risks.

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A Discussion of Intermediate School Districts (ISDs) **By Kathryn Summers-Coty, Fiscal Analyst**

Recent newspaper investigative reports have triggered legislative interest in intermediate school districts, often referred to as ISDs. This article defines an ISD, provides basic factual information on ISDs statewide, discusses taxing authority and range of duties, and presents board member election information. Finally, a brief discussion of recently introduced legislation related to ISDs is included.

An intermediate school district is a public agency that may educate pupils; provide for the safety and welfare of pupils; acquire or construct facilities; hire, supervise, or terminate employees; and receive, invest, or borrow money. There are 57 ISDs in Michigan, created in 1962, when the State's 83 county school districts were reorganized as ISDs. More recently, some ISDs have been renaming themselves as regional education service agencies (RESAs) or districts (RESDs). Every local school district belongs to an ISD, and therefore each ISD has "constituent school districts".

While each ISD's functions vary from the others, a common thread linking nearly all lies in Special Education and Vocational Education services. Often, an ISD will operate a "center program" for special education students, particularly those students with extreme or rare disabilities. This "center program", then, educates those students in any of the local school districts who are constituents of the ISD.

The same can hold true with Vocational Education programs. The ISD, with a central location, may offer training to any constituent students to prepare them for entering a field immediately upon graduation.

Sometimes, ISDs partner with one or more of their constituent districts to operate State-funded programs, or they may run the programs separately. Examples of such School Aid programs include School Readiness (pre-school for at-risk 4-year-olds), Adult Education, Math and Science Centers, Court-Placed Pupils (educating pupils placed in the setting by the courts), and Bus Driver Safety education.

Services provided by ISDs also can include administrative functions. Often, small local school districts may not have the budget or personnel needed to handle items such as payroll or purchasing, and may contract with the ISD to provide these services. In fact, the Revised School Code requires an ISD to provide management services upon request of the board of a constituent district, though the ISD may charge the district for such services provided. Discretionary ISD duties listed in the School Code include participation in cooperative programs for information technology systems; provision of school improvement support services, distance learning, and transportation services; and operation of an educational recreation program. Each ISD's array of services reflects the needs of its constituent districts, and therefore each is different.

All ISDs receive operational funding (i.e., funding whose use is not prescribed) under Section 81 of the School Aid Act. In addition, with voter approval, an ISD may levy operational millage up to 1.5 times the number of mills allocated to the ISD in 1993 for operations. The

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ISD also may ask voters to approve millage requests for special education and vocational education. Statewide, all ISDs are currently levying operating and special education millages, and 31 out of the 57 are levying vocational education millages. Intermediate school districts are also eligible for State millage equalization funding appropriated in the School Aid Act, if the local funding received under either special or vocational education mills does not meet a prescribed threshold.

Each intermediate school district is under the supervision and control of an intermediate school board. At this time, an ISD may choose whether its board members are elected by popular election, or whether they are elected by a group composed of one member of each of the boards of constituent districts. Each ISD board member's term is six years; vacancies are appointed by the remaining members of the ISD board until the next biennial election. Each ISD has a superintendent who is hired by the ISD board.

Recently introduced legislation pertaining to ISDs is described below:

- Senate Bill (S.B.) 837 and House Bill (H.B.) 5043 would provide a recall procedure for ISD board members.
- H.B. 4338 would require all ISD board members to be elected via popular elections.
- H.B. 4935 would allow intermediate school electors to vote for the removal of an ISD board and for the appointment of a reform board for the ISD under certain circumstances.
- S.B. 643 and H.B. 4947 would require public disclosure of school boards' voting preferences for ISD board members.
- H.B. 5108 would require the reporting of any conflict of interest by ISD employees or administrators.
- H.B. 5457 would require the Department of Treasury to conduct random financial audits of ISDs.
- H.B. 5458 would require constituent districts to approve their ISD's budget.
- H.B. 5475 would require the Department of Education to operate an internet-accessible database regarding certain ISD expenditures.

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Balancing the State General Fund/General Purpose Budget: Four Consecutive Years of Fiscal Stress

by Gary S. Olson, Director

The slowing of the United States and Michigan economies, which began in the spring of 2000, ended up having a very significant impact on state budgets. The economic slowdown, coupled with a massive drop in the valuation of equity stocks, resulted in actual state revenue collections' falling below the initial estimates on which state appropriations were based. This decline in state revenue collections forced most states to institute significant changes in their state budgets from the point that original spending plans were recommended by state Governors until the final revenue and expenditure totals were reached at the close of the states' fiscal years.

This article provides a summary of the steps that the Michigan Governors and the Legislature took to adjust the State's General Fund/General Purpose (GF/GP) budget from the original recommendation of the Governor to the final revenue and expenditure totals. The analysis covers fiscal years 2000-01, 2001-02, 2002-03, and 2003-04, the four recent fiscal years most affected by the deteriorating economic conditions.

The Michigan budget process begins in the winter before the start of the State's next fiscal year, when the Governor, pursuant to constitutional and statutory requirements, delivers a detailed budget recommendation to the Legislature. This budget recommendation includes any recommended tax policy changes along with a comprehensive set of recommended appropriations for each State department or agency. The Governor's budget recommendation sets off a budget process that concludes at the end of the fiscal year when the final accounting of actual State revenues and expenditures is completed.

In order to analyze the changes in the Michigan GF/GP budget from the original recommendation of the Governor to the final revenue and expenditure figures, various assumptions are used. A comparison of the Governor's original GF/GP appropriation recommendation to the final level of GF/GP ongoing revenues is undertaken. The difference between these two numbers is the amount of deficit that the Governor and the Legislature were forced to eliminate throughout the fiscal year in order to keep the GF/GP budget in balance. This analysis will explain in each of the three fiscal years how much of this deficit was eliminated as a result of reductions in appropriations from the Governor's original recommendation versus tax policy changes that increased revenues above the amount assumed in the Governor's original budget versus other policy changes that had the impact of providing increased GF/GP revenue to support appropriations.

Fiscal Year 2000-01 GF/GP Budget

On January 27, 2000, Governor John Engler presented to the Legislature his recommendation for the fiscal year (FY) 2000-01 GF/GP budget. The Governor recommended GF/GP appropriations of \$9.64 billion. When the final accounting of FY 2000-01 GF/GP revenues was completed, the amount of ongoing GF/GP revenues actually collected totaled \$8.99 billion, for an imbalance of \$647.9 million from the Governor's original appropriation recommendation.

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Table 1 provides a summary of the actions that the Governor and the Legislature took to eliminate this imbalance.

In terms of appropriations, the actual level of FY 2000-01 GF/GP expenditures exceeded the level originally recommended by the Governor by \$79.1 million. The imbalance was closed by a variety of actions that provided for non-ongoing increases in GF/GP revenue. These revenue increases included a \$270.1 million withdrawal from the Budget Stabilization Fund, the use of a \$211.8 million beginning balance carried forward from FY 1999-2000, a \$211.2 million funding shift in the construction of new State-financed buildings from a cash system of financing to debt issued by the State Building Authority, a \$20.0 million transfer of Tobacco Settlement Trust Fund revenue, and \$42.1 million of revenue from the liquidation of several prior work project accounts. These actions in total eliminated the imbalance and allowed FY 2000-01 to close with a \$28.1 million balance.

Table 1 FY 2000-01 General Fund/General Purpose Budget Summary Governor's Original Proposal to Final Bookclosing (millions of dollars)	
Governor's Original Appropriation Recommendation	\$9,637.4
Final Consensus Revenue Collections	8,989.5
Difference	\$ (647.9)
<u>Actions Taken to Balance Budget:</u>	
GF/GP Appropriation Increases	(79.1)
<u>Non-Ongoing Revenue Sources:</u>	
Budget Stabilization Fund Withdrawal	270.0
Use of Prior Year-End Balance	211.8
Tobacco Settlement Trust Fund Transfer	20.0
State Building Authority Funding Shift	211.2
Work Project Reductions	42.1
Subtotal Non-Ongoing Revenue Adjustments	<u>\$755.1</u>
Remaining Balance	\$ 28.1

Fiscal Year 2001-02 GF/GP Budget

On February 8, 2001, Governor Engler presented to the Legislature his recommendation for the FY 2001-02 GF/GP budget. The Governor recommended GF/GP appropriations of \$9.78 billion. When the final accounting of FY 2001-02 GF/GP revenue was completed, the amount of ongoing GF/GP revenue actually collected totaled \$8.28 billion, for an imbalance of \$1.51 billion from the Governor's original appropriation recommendation. Table 2 provides a summary of the actions that the Governor and the Legislature took to eliminate this imbalance.

In terms of appropriations, the actual level of FY 2001-02 GF/GP appropriations was \$662.5 million below the level originally recommended by the Governor. The remaining amount of the

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\$1.51 billion imbalance was closed by non-ongoing GF/GP revenue increases. These revenue increases included a \$452.8 million withdrawal from the Budget Stabilization Fund, the use of a \$28.1 million beginning balance carried forward from FY 2000-01, a \$131.5 million transfer from the Merit Award Trust Fund, a \$27.5 million transfer from the Tobacco Settlement Trust Fund, a \$60.5 million revenue increase from a reduction in the statutory level of revenue sharing payments, a \$79.5 million transfer from the Employment Contingency Fund, a \$63.0 million transfer from statutory restricted transportation funds, a \$56.0 million revenue increase from the shifting of the financing of homestead property tax credits to available Federal funds, a \$15.5 million revenue increase from a tax amnesty program, a \$28.7 million revenue increase from the liquidation of several prior year work project accounts, and \$17.3 million from other fund shifts and revenue adjustments. These actions in total eliminated the imbalance and allowed FY 2001-02 to close with a \$114.5 million balance.

Table 2 FY 2001-02 General Fund/General Purpose Budget Summary Governor's Recommendation to Final Bookclosing (millions of dollars)	
Governor's Original Appropriation Recommendation	\$9,784.6
Final Consensus Revenue Collections	8,276.2
Difference	\$(1,508.4)
<u>Actions Taken to Balance Budget:</u>	
GF/GP Appropriation Reductions	662.5
<u>Non-Ongoing Revenue Sources:</u>	
Budget Stabilization Fund Withdrawal	452.8
Use of Prior Year-End Balance	28.1
Merit Award Trust Fund Transfers	131.5
Tobacco Settlement Trust Fund Transfers	27.5
Revenue Sharing Reductions	60.5
Employment Contingency Fund Transfer	79.5
Transportation Funding Shifts	63.0
Homestead Property Tax Credit to TANF	56.0
Tax Amnesty Revenue	15.5
Work Project Reductions	28.7
Other Revenue/Fund Shift Adjustments	17.3
Total Adjustments to Balance Budget	\$1,622.9
Actual Year-End Balance	\$ 114.5

Fiscal Year 2002-03 GF/GP Budget

On February 7, 2002, Governor Engler presented to the Legislature his recommendations for the FY 2002-03 GF/GP budget. The Governor recommended GF/GP appropriations of \$9.29 billion. The consensus estimate of FY 2002-03 ongoing GF/GP revenue was \$7.71 billion, for

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an imbalance of \$1.58 billion from the Governor's original appropriation recommendation. Table 3 provides a summary of the actions that Governor Engler, Governor Granholm, and the Legislature took to eliminate this imbalance.

Table 3 FY 2002-03 General Fund/General Purpose Budget Summary Governor's Original Proposal to Final Bookclosing (millions of dollars)	
Governor's Original Appropriation Recommendation	\$ 9,285.3
Final Revenue Collections	7,709.8
Difference	\$ (1,575.5)
<u>Actions Taken to Balance Budget:</u>	
GF/GP Appropriation Reductions	520.6
<u>Revenue Increases:</u>	
Tobacco Tax Increase	141.6
Pause in Single Business Tax Rollback	76.3
Subtotal Revenue Increases	\$ 217.9
<u>Other Non-Ongoing Revenue Sources:</u>	
Budget Stabilization Fund Withdrawal	124.1
Use of Prior Year-End Balance	114.5
Merit Award Trust Fund Transfer	151.3
Tobacco Settlement Trust Fund Transfer	14.6
Revenue Sharing Reductions	146.2
Revenue Sharing Reserve Account	181.0
Unrestricted Federal Aid	169.0
SERS Pre-Funded Health Reserve	58.2
Liquor Purchase Revolving Fund Transfer	3.7
Waterways Fund Transfer	7.8
Hospital Assessment Revenue	8.9
Investor Lawsuit Settlement	13.5
Vitamin Lawsuit Settlement	10.6
Tobacco Company Lawsuit Settlement	7.6
Subtotal Non-Ongoing Revenue Sources	\$1,011.0
Total Actions Taken to Balance Budget	\$1,749.5
Remaining Balance	\$174.0

During the summer of 2002, the Legislature, as a result of a recommendation from Governor Engler, took two actions with tax policy implications to address the imbalance. The rate of the excise tax on cigarettes was increased from 75 cents per pack to \$1.25 per pack. A portion of this revenue increase, totaling \$141.6 million, was dedicated to the GF/GP budget. The other tax policy change implemented at this time was a suspension of the 0.1 percentage point reduction in the rate of the single business tax (SBT) scheduled to occur on January 1, 2003.



This suspension of the SBT rate reduction resulted in a \$76.3 million increase in FY 2002-03 GF/GP revenue.

In terms of appropriations, the year-to-date level of FY 2002-03 GF/GP appropriations was \$520.6 million below the level originally recommended by Governor Engler. The remaining amount of the \$1.58 billion imbalance was closed by non-ongoing GF/GP revenue increases. These revenue increases included a \$124.1 million transfer from the Budget Stabilization Fund, the use of a \$114.5 million beginning balance carried forward from FY 2001-02, a \$151.3 million transfer from the Merit Award Trust Fund, a \$14.6 million transfer from the Tobacco Settlement Trust Fund, \$146.2 million from a reduction in the level of statutory revenue sharing payments, \$181.0 million from a transfer of a revenue sharing reserve account, \$169.0 million from unrestricted Federal funds, \$58.2 million from a transfer from the State Employees Retirement System, \$31.6 million from the settlement of three lawsuits, and several other non-ongoing revenue items that increased revenues by \$20.4 million. These actions eliminated the imbalance and allowed the FY 2002-03 GF/GP budget to close with a \$174.0 million balance.

FY 2003-04 GF/GP Budget

On March 6, 2003, Governor Jennifer Granholm presented to the Legislature her recommendations for the FY 2003-04 GF/GP budget. The Governor recommended GF/GP appropriations of \$8.59 billion. The current consensus estimate of ongoing GF/GP revenues is \$7.78 billion, for an imbalance of \$810.7 million from the Governor's original appropriation recommendation. Table 4 provides a summary of the actions that Governor Granholm and the Legislature took to eliminate this imbalance.

During December 2003, the Legislature approved and the Governor signed into law legislation that paused a scheduled reduction in the rate of the State income tax. The income tax rate reduction from 4.0% to 3.9%, which was scheduled to occur on January 1, 2004, was delayed until July 1, 2004. This income tax rate reduction pause resulted in a \$77.0 million increase in FY 2003-04 GF/GP revenue.

In terms of appropriations, the year-to-date level of GF/GP appropriations is \$221.7 million above the amount originally recommended by the Governor. This increase is mostly related to the level of the GF/GP grant to the K-12 School Aid Fund. The Governor's original budget recommendation contained no GF/GP grant to the School Aid Fund, while the year-to-date GF/GP grant to the School Aid Fund is \$327.7 million.

The remainder of the \$810.7 million FY 2003-04 GF/GP budget imbalance was closed by non-ongoing GF/GP revenue increases. These revenue increases included the use of a \$174.0 million beginning balance carried forward from FY 2002-03, \$289.7 million from a reduction in the level of statutory revenue sharing payments, \$169.0 million from unrestricted Federal funds, \$76.6 million from the sale of surplus State property, \$65.0 million from fee increases related to driver responsibility legislation, \$25.9 million from increases in the cost of driver licenses, \$49.0 million from the enhanced enforcement of State tax laws, \$39.6 million from work projects accounts that were closed out, \$15.0 million from escheats law revisions, \$10.0 million from a transfer from the Employment Security Fund, and \$70.9 million from the transfer to the General

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Fund of a variety of other restricted revenue accounts. These action eliminated the imbalance and will allow the FY 2003-04 GF/GP budget to close with a \$29.3 million estimated year-end balance.

Table 4 FY 2003-04 General Fund/General Purpose Budget Summary Governor's Original Proposal to Current Enacted Budget (millions of dollars)	
Governor's Original Appropriation Recommendation	\$8,591.2
Current Estimated Consensus Revenue Collections	7,780.5
Difference	\$(810.7)
<u>Actions Taken to Balance Budget:</u>	
GF/GP Appropriation Increases	(221.7)
<u>Revenue Increases:</u>	
Pause in Income Tax Rate Rollback	77.0
<u>Other Non-Ongoing Revenue Sources:</u>	
Use of Prior Year-End Balance	174.0
Revenue Sharing Reductions	289.7
Unrestricted Federal Aid	169.0
Sale of Surplus State Property	76.6
Driver Responsibility Fee Increases	65.0
Drivers License Fee Increases	25.9
Enhanced Enforcement of Delinquent Taxes	49.0
Work Project Lapses to General Fund	39.6
Escheats Law Revision	15.0
Transfer from Employment Security Fund	10.0
Restricted Revenue Transfers to General Fund	70.9
Subtotal Non-Ongoing Revenue Adjustments	\$ 984.7
Total Actions Taken to Balance Budget	840.0
Projected Year-End Balance	\$ 29.3

Summary

During the past four fiscal years, the Michigan GF/GP budget has faced a total of \$4.54 billion in projected imbalances between the Governor's original appropriation recommendation and the final level of ongoing GF/GP revenue collections. Table 5 provides a summary of the actions that were taken over this four-fiscal year-period to eliminate these budget imbalances. Appropriation reductions over the period totaled \$882.3 million or 18.0% of the total adjustments taken to eliminate the imbalances. Other major actions taken to eliminate the imbalances included transfers from the Budget Stabilization Fund, \$848.9 million or 17.3% of the total adjustments; the use of prior year-end balances of \$528.4 million or 10.8% of the total adjustments; tobacco settlement transfers of \$344.9 million or 7.1% of the total adjustments; statutory revenue sharing reductions of \$496.4 million or 10.2% of the total adjustments; unrestricted Federal aid of \$338.0 million or 6.9% of the total adjustments; revenue increases

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of \$294.9 million or 6.0% of the total adjustments; a revenue sharing reserve account transfer of \$181.0 million of 3.7% of the total adjustments; a State Building Authority fund shift of \$211.2 million or 4.3% of the total adjustments; the sale of surplus State property of \$76.6 million or 1.6% of the total adjustments; and \$687.8 million of other various adjustments that accounted for 14.1% of the total adjustments.

Table 5 Actions Taken to Balance GF/GP Budgets (millions of dollars)						
	FY 2000-01	FY 2001-02	FY 2002-03	FY 2003-04	Total	% of Total
Potential Deficit	\$(647.9)	\$(1,508.4)	\$(1,575.5)	\$(810.7)	\$4,542.5	
Appropriation Reductions	(79.1)	662.5	520.6	(221.7)	882.3	18.0%
Budget Stabilization Fund Transfers	270.0	452.8	124.1	0.0	846.9	17.3%
Use of Prior Year-End Balance	211.8	28.1	114.5	174.0	528.4	10.8%
Tobacco Settlement Transfers	20.0	159.0	165.9	0.0	344.9	7.1%
Revenue Increases	0.0	0.0	217.9	77.0	294.9	6.0%
State Bldg Authority Fund Shift	211.2	0.0	0.0	0.0	211.2	4.3%
Rev. Sharing Statutory Reductions	0.0	60.5	146.2	289.7	496.4	10.2%
Rev. Sharing Reserve Transfer	0.0	0.0	181.0	0.0	181.0	3.7%
Unrestricted Federal Aid	0.0	0.0	169.0	169.0	338.0	6.9%
Sale of Surplus State Property	0.0	0.0	0.0	76.6	76.6	1.6%
All Other Fund Shifts/Transfers	42.1	260.0	110.3	275.4	687.8	14.1%
Total Adjustments	\$676.0	\$1,622.9	\$1,749.5	\$840.0	\$4,888.4	100.0%
Year-End Balance	\$ 28.1	\$ 114.5	\$ 174.0	\$ 29.3		

It is clear that Governor Engler, Governor Granholm, and the Legislature have used a wide array of fiscal changes in order to keep the GF/GP budget in balance over the past four fiscal years. The use of these fiscal adjustments is important to an understanding of how the budget has been balanced and also provides a source of budget-balancing ideas that could be used in future economic downturns.

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Cell Phones and Driving: A Dangerous Mix? **By Patrick Affholter, Legislative Analyst**

Anyone who has driven on American roads in recent years has witnessed the proliferation of cellular phone use by drivers. According to a 2003 National Conference of State Legislatures (NCSL) *Legislative Update*, the number of wireless telephone subscribers in the United States doubled in the previous five years to more than 151 million, and estimates on the percentage of motorists who use their phones while driving range from 50% to as high as 73%.¹

Anecdotal evidence of driver distraction caused by cell phone use is abundant. There has been a plethora of television, radio, print media, and on-line commentaries on the topic, and scientific studies have examined the effects of cell phone use and other driver distractions.

Public attention to the issue has grown along with the rate of cell phone use and media commentary, and state legislatures have considered a variety of approaches to restricting drivers' use of cell phones. Although Michigan has not enacted new laws to address cell phone use while driving, bills on the subject have been introduced in the State Legislature, and other states have adopted measures regulating the use of wireless phones by some drivers.

This article examines some of the studies pertaining to motorists' cell phone use and some responses to the studies. The article also describes legislative action taken in various states to address the issue of driver distraction by cell phone use.

Studies of the Effects of Drivers' Cell Phone Use

The pioneering study on cell phone use and driving was published in the *New England Journal of Medicine (NEJM)* in February 1997. The project studied 699 drivers in the Toronto area who had cellular phones and were involved in automobile collisions. Calls on the day of each collision were analyzed through the use of billing records. By comparing the billing records with accident reports, the researchers concluded that using cell phones in motor vehicles "is associated with a quadrupling of the risk of a collision during the brief period of a call".²

In the same issue, the *NEJM* editors reported the findings of the journal's further analysis of the data from the Toronto study. The editors suggested that the risk of a collision "more than doubled within five minutes after the start of a call" and that 6% to 12% of the collisions in the study could be attributed to cell phone use. The editors concluded that, while the study did not adequately address the use of hands-free telephone devices, prohibiting drivers from using hand-held telephones "can still be justified by the...experimental evidence".³

While the *NEJM* study did not distinguish between the use of hand-held and hands-free phones, some "studies suggest that hands-free phones are not risk-free because communicating effectively with someone you can't see takes twice as much mental effort, causing some drivers to zone out on the road",⁴ according to a July 2000 *Detroit News* article. Indeed, a study published in March 2000 evaluated the "consequences of performing verbal and spatial-imagery tasks on visual search when driving".⁵ According to the *Detroit News* article, that study "found



that cognitive tasks, such as engaging in emotional or in-depth phone conversations, narrows drivers' field of vision so that they scan traffic and look at their rear-view mirrors less often".⁶

In April 2002, *Michigan Radio* reported on a study conducted by researchers at the University of Central Florida and the Liberty Mutual insurance company that examined the use of hands-free cell phones. According to the radio report, the study showed that "drivers who use hands-free cell phones still have a greater risk of getting into an accident" and "found that drivers using the hands-free devices sometimes failed to stop at red lights and often braked much harder than usual".⁷ The same story cited a researcher at the University of North Carolina's Highway Safety Research Center (HSRC) who explained that hands-free cell phone devices do not reduce the mental demands on a driver. Since a passenger in a car conversing with the driver is able to see what is happening with traffic, he or she can moderate the conversation accordingly, but the other person in a phone conversation, regardless of whether the driver uses a hands-free phone, cannot accommodate the driver based on traffic conditions and the driver's attention is diverted from safely operating the vehicle to engaging in the conversation.⁸

A more recent study, focusing on cell phone use by drivers in North Carolina, was conducted by the HSRC in 2002. Extrapolating from their findings, researchers projected that the total number of cell phone-related crashes in that state would be almost 1,500 annually. The researchers found that cell phone-related crashes "were nearly twice as likely to involve rear-end collisions (45.1% versus 25.6%)" and that the most common driver violations for cell phone users involved in crashes were failure to reduce speed (23.5%), traffic signal violation (9.6%), speeding (4.9%), following too closely (3.5%), and failure to yield (3.5%).⁹

Further, the NCSL report cited a 2003 article published by the Harvard Center for Risk Analysis that estimated that cell phone use by drivers may cause approximately 2,600 deaths, 330,000 moderate to critical injuries, and 1.5 million instances of property damage in America per year.¹⁰

Reaction to the Studies

Judging by research projects like those discussed above, it might seem that a clear link has been established between drivers' cell phone use and the likelihood of traffic accidents, and that policies should be adopted to restrict the use of cell phones by drivers. Indeed, in an on-line press release for an HSRC survey, the former deputy director of that research center stated: "It's absolutely clear from the research literature that talking on a cell phone while driving does elevate the risk of a crash...Using cell phones slows reaction times and degrades drivers' tracking abilities."¹¹

Opponents of regulating motorists' cell phone use, however, are not convinced. They contend that, while use of a cell phone might distract a driver temporarily, using a phone is no more dangerous than other distractions that are not regulated, such as eating, adjusting the radio, or conversing with passengers. A 2001 MSNBC column suggested that car phones are being demonized and that the same logic some rely on to advocate against their use could be used to prohibit other activities that distract drivers. The column cited an American Automobile Association (AAA) study that found that the use of cell phones caused only about 1.5% of the 284,000 distraction-related accidents each year. According to the column, the AAA study also



found that 1.7% of those accidents were caused by eating and drinking, 10.8% were caused by distraction due to other occupants of the vehicle, 2.8% were due to drivers' adjusting the air conditioner or heater, 11.4% were caused by drivers' adjusting the radio, cassette, or CD player, and 15% resulted because the driver simply was not paying attention.¹²

Also, as pointed out by the NCSL's 2003 *Legislative Update*, while "it is clear that both the use and complexity of technology in the car have increased, the effects of this technology are in dispute". Proponents of cell phone restrictions contend that, unlike other types of driver distraction, the use of "phones and other in-vehicle communication devices takes a driver's attention away from the road more dangerously than do other activities". Opponents of cell phone restrictions, however, "often cite the value of wireless phones and other devices as a reason against singling them out for regulation". The NCSL reported that, according to the Cellular Telecommunications and Internet Association (CTIA), "more than 160,000 emergency calls are placed on wireless phones every day" and cell phones "can be used to promote on-the-road safety programs such as the Amber Alert system".¹³ Indeed, the widely-cited 1997 *NEJM* study stated in its conclusions that decisions about regulating cell phones "need to take into account the benefits of the technology".¹⁴

In addition, critics of regulating drivers' cell phone use point out that the use of a cell phone at or around the time of a traffic accident does not necessarily mean that one caused the other. According to the MSNBC column, simply showing that accidents involved cell phone use does not imply that use of the phones caused the accidents, but only proves something that we already know: "more people are using cell phones, so of course more of the people who are in accidents are on the phone at the time". The column characterized the number of traffic accidents to which cell phones contribute as hardly "a blip on the radar screen", compared with the 6.3 million accidents reported annually nationwide, and claimed that limiting cell phone use "will not impact the number of accidents or fatalities".¹⁵

Legislative Measures and Proposals

To date, no state has completely banned drivers from using cell phones. In 2001, New York became the first (and still only) state to prohibit drivers from using hand-held phones. According to a 2003 *New York Times* News Service article, however, relatively few tickets were being issued for the violation ("Study Finds Phones Are Back In New York Drivers' Hands"). Between December 2001 and February 2003, about 100,500 citations were issued, accounting for only 2% of all traffic citations. In addition, the article reported that, although drivers' use of hand-held cell phones decreased by about 50% immediately after the New York law went into effect and police began issuing warnings to drivers in November 2001, a study by the Insurance Institute for Highway Safety revealed that compliance with the law had dropped by about half in less than two years.¹⁶

While New York continues to have the most extensive regulation of drivers' cell phone use, the NCSL reported that bans similar to New York's were proposed in 33 states in 2003. Although none of those proposals was enacted, they passed one legislative chamber in California, Connecticut, Hawaii and New Jersey.¹⁷

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In addition, some measures are aimed at specific types of drivers. Maine and New Jersey, for instance, prohibit cell phone use by drivers under 21 years old who have a learner's or instructional permit. In 2003, nine other states considered bills related to young drivers' cell phone use. Also, seven states prohibit school bus drivers from using cell phones while behind the wheel of a bus and similar legislation was proposed in six states in 2003.¹⁸

The NCSL further reported on an "emerging trend...to address a broad range of behaviors" that may distract drivers. Last year, Oregon enacted a measure that prohibits "distracting activities" while driving. "Distracting activity" is defined as "responding to events, persons or objects inside or outside the vehicle that are not related to the safe operation of the vehicle". Violators of the Oregon law are subject to fines of up to \$150. While Oregon was the only state to enact such a measure in 2003, similar legislation was introduced in nine other states.¹⁹

Some states, on the other hand, took action to restrict local laws pertaining to cell phone use and driving. These restrictions were passed by legislatures in eight states, most notably Florida, where several local units of government, including Miami-Dade County, had taken measures to prohibit drivers' use of hand-held phones. Municipalities in Massachusetts, New Jersey, New Mexico, New York, Ohio, Pennsylvania, and Utah also have passed bans, though many are not enforcing their laws because of court challenges, attorney general opinions, or state preemption.²⁰

The Federal government has not acted on distracted driving issues to date, but proposed legislation would require states to prohibit the use of hand-held phones by drivers or lose 5% of Federal transportation funding. The NCSL report suggested, however, that the Federal legislation is not expected to move out of committee.²¹

Michigan Statistics and Proposals

Although Michigan has not enacted any restrictions on cell phone use by drivers, law enforcement agencies have begun collecting relevant statistics in traffic accident reports. According to "2002 Michigan Traffic Crash Facts", there were 395,515 reported motor vehicle crashes in Michigan during 2002, and "driver using a cell phone" was recorded as a possible condition of the driver in 870 of those incidents. The report noted, however, that because some conditions are known only if the driver admits to them, certain driver conditions may be under-reported.²²

To date, three legislative proposals pertaining to driver use of cell phones have been introduced in the current legislative session:

- Senate Bill 555, sponsored by Senator Bruce Patterson and referred to the Senate Committee on Technology and Energy, would require the Secretary of State to add one point to a driver's record for each conviction, civil infraction determination, or probate court disposition if the citation indicated that the use of a cell phone contributed to the cause of a traffic violation. The bill also would require an additional \$25 civil fine for a civil infraction traffic violation if it were determined that using a cell phone contributed to the cause of the violation.

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- House Bill 5084, sponsored by Representative Frank Accavitti, Jr. and referred to the House Committee on Transportation, would prohibit a driver from using a hand-held cell phone while driving, if the driver had a temporary instruction permit or a level 1 or 2 graduated license status. A violation would be a civil infraction.
- House Bill 5085, sponsored by Representative Jack Minore and referred to the House Committee on Transportation, would prohibit cell phone communication by a driver who had a temporary instruction permit or a level 1, 2, or 3 graduated license status.

In recent legislative sessions, bills that proposed all of the following were introduced, but not acted upon:

- Adding points to a person's driver's license and increasing civil fines for a traffic violation, if the violation involved the driver's use of a cell phone (House Bill 4158 of 2001-02 and House Bill 5567 of 1999-2000).
- Including use of a hand-held cell phone while driving in the current civil infraction of operating a vehicle in a careless or negligent manner (House Bill 5015 of 2001-02 and Senate Bill 1015 of 1999-2000).
- Requiring a police officer's crash report to indicate whether a cell phone was in use by one or more of the drivers at the time of the crash, and requiring the Department of State Police to compile statistics on the extent of cell phone use, based on information gathered from crash reports (House Bill 5101 of 2001-02).
- Prohibiting a person from operating a vehicle while using a hand-held cell phone that prevented the person from having both hands on the steering wheel (House Bill 5862 of 1999-2000).

Conclusion

There has been a marked increase in the availability of cell phones in recent years, and subscription rates have escalated accordingly. Not surprisingly, this has resulted in a commensurate increase in cell phone use by drivers. Anyone who drives on Michigan's roads no doubt has noticed more drivers talking on phones and has witnessed poor or careless driving by those people. The evidence is more than anecdotal, however, as numerous studies have shown that driver distraction related to cell phone use may contribute to traffic accidents that can cause property damage, injury, or death.

As motorists' cell phone use has risen, so too has public interest in the issue, leading to legislative action to regulate the practice. Although Michigan has not enacted any restrictions on drivers' using a cell phone, New York prohibits drivers from using hand-held phones and a number of other states have taken measures to restrict cell phone use by certain vehicle operators, such as school bus drivers and young, inexperienced drivers. Policy-makers have been cautioned, however, to consider the issue in a broader context, weighing the relative risk compared with other types of driver distraction and the benefits of cell phone technology, such as the ability to report emergencies.

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End Notes

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- ² *New England Journal of Medicine*, Volume 336, No. 7, "Association Between Cellular-Telephone Calls and Motor Vehicle Collisions".
- ³ *NEJM*, Volume 336, No. 7, "Cautions About Car Telephones and Collisions.
- ⁴ *Detroit News*, "Car Phones: Unsafe At Any Speed?", July 31, 2000.
- ⁵ *Journal of Experimental Psychology*, Volume 6, No. 1, "Effects of Verbal and Spatial-Imagery Tasks on Eye Fixations While Driving".
- ⁶ *Detroit News*, Op. Cit.
- ⁷ Transcript of *Michigan Radio* report, April 2, 2002.
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- ⁹ Highway Safety Research Center, "Cell Phone Use While Driving in North Carolina: 2002 Update Report", December 2002.
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- ¹¹ HSRC, "Cell Phones and Driving: How Dangerous is the Combination?"
http://www.hsrc.unc.edu/pressrelease/cell_phone.htm.
- ¹² Elliot Zaret, MSNBC on-line column, "Stop Demonizing Cell Phones!", May 24, 2001.
- ¹³ NCSL, Op. Cit.
- ¹⁴ *NEJM*, Op. Cit.
- ¹⁵ Zaret, MSNBC, Op. Cit.
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- ¹⁷ NCSL, Op. Cit.
- ¹⁸ NCSL, Op. Cit.
- ¹⁹ NCSL, Op. Cit.
- ²⁰ NCSL, Op. Cit.
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- ²² "2002 Michigan Traffic Crash Facts", published by the University of Michigan Transportation Research Institute for the Department of State Police Office of Highway Safety Planning, with data on file at the Department.